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C O N F I D E N T I A L SECTION 01 OF 03 SANAA 003609

SIPDIS

E.O. 12958: DECL: 12/28/2015

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SUBJECT: WATANI BANK FAILURE THREATENS BROADER FINANCIAL CRISIS

REF: SANAA 3556

Classified By: Ambassador Thomas C. Krajewski for reasons 1.4 (b) and (d).

1. (C) SUMMARY. In early December, the Central Bank of Yemen (CBY) declared Watani Bank insolvent, and initiated the first bank closure in Yemen's history. General Manager Dr. Hamdani, and other bank officials, were arrested and face charges of financial crimes against the state. Watani's future remains unclear, but it is likely that the CBY will be forced to liquidate its assets. The bank suffered from poor management for several years, leading to its own board of directors and political insiders, and used political connections to prevent earlier disciplinary action by the CBY. Such practices are prevalent at other banks in Yemen, and could point to a broader financial crisis in the coming year. END SUMMARY.

ROYG Closes First Bank in Yemeni History

2. (SBU) On December 7, military police appeared at the main branch of Watani Bank in Sanaa, locked the doors and declared the bank insolvent. The CBY immediately took control of the board of directors and froze all accounts. CBY officials explained that the police arrived in response to rioting caused by a run on the bank totaling approximately USD five million, sparked by the CBY's inability to clear checks guaranteed by Watani. According to Abdullah al-Olafi, Sub-Governor for Supervision at the CBY, Watani had zero liquidity and held only its statutory reserves when it failed. The closure is the first in Yemen's history, with the exception of a branch of BCCI. The CBY is now faced with the choice of liquidation, new management, or returning the bank to its shareholders.

3. (C) Shortly before the closure, police stopped the bank's General Manager, Dr. Ahmad al-Hamdani, from leaving the country. The Attorney General's (AG) office issued a warrant for the arrest of Hamdani and eight other senior bank officials on December 18. Dr. Hamdani and three others turned themselves in voluntarily and remain in prison, while others remain in hiding. (Reftel) Al-Hamdani, a dual Yemeni-American citizen, appeared in court for preliminary questioning on December 19, charged with "wasting bank funds" and of "causing economic damage to the country." The ROYG froze the bank accounts and real estate holdings of Dr. Hamdani's relatives, including his children and aunts and uncles. On December 28, Hamdani submitted an official request for help from post, asserting that he is being held without bail and falsely accused of embezzlement. The AG also took the unusual step of trying Hamdani in the Special Penal Court, usually reserved for those who pose a "public danger" or are charged with capital crimes. (NOTE: Though an odd choice of venue for trying financial crimes, the Special Penal Court is one of the few well-functioning arms of the Yemeni judicial system. END NOTE.)

Watani Survived on Political Connections

4. (C) There is little question that Watani was experiencing severe liquidity problems before its closure. Hamdani himself admitted that Watani suffered from a high volume of non-performing loans, but blamed his troubles on government contractors who were awaiting payment from the Ministry of Finance (MOF). Approximately sixty major contracting companies, many belonging to well-connected politicians and tribal sheikhs, have failed to make loan payments. Watani officials argue that despite direct orders from President Saleh and Prime Minister Bajammal, MOF refuses to issue payment for the contracts in question. The CBY counters that these loans were made without sufficient guarantees and in violation of banking regulations. Yemen's ineffective court system and pervasive corruption also make it difficult to settle such cases -- especially when borrowers have political connections. (NOTE: It is standard practice for MOF to delay payment as a means of bridging deficits and extending contracts into the following year's budget. END NOTE.)

5. (C) Watani began on poor financial footing in 1998, said Ahmed al-Absi, General Manager of the International Bank of

Yemen, and was mismanaged until the day of its closure. With only four branches and start-up capital of USD 3 million, Watani was small even by Yemeni standards. Hamdani, a former minister of agriculture and economy, had strong connections with ROYG officials, said al-Absi, and made investments no other bank would consider. Watani held the equivalent of USD 88 million in deposits (USD 15 million in statutory reserves at the CBY) and issued loans totaling USD 70 million. According to al-Absi, Watani made USD 30 million in loans to the bank's own board of directors, a violation of Yemen's banking law. Another USD 30 million were issued to government contractors, many of whom had no credit history. Some of the loans were made to single individuals in excess of 15 percent of the bank's total capital, also a violation of the law. Watani Bank never made a profit in all its years of operation.

16. (C) The bank conducted little in the way of core banking services, continued al-Absi, expanding into risky real estate and insurance ventures. In a desperate attempt to solve its liquidity troubles, Watani began paying above market rate to depositors. Three years ago, said Olafi, the CBY forbade Watani from making additional loans until it had settled accounts for non-performing loans. Nevertheless, Watani continued to lend. "Dr. Hamdani is the type of guy who likes to please his friends and associates," said Fathi Khairi, Watani's former auditor with Deloitte and Touche.

Central Bank Acted Too Late

17. (C) George Mullinax, a banking expert with the MEPI-funded regional office of the Treasury Department in Abu Dhabi, is providing technical assistance to the CBY in administering the Watani closure. The real problem, said Mullinax, is that the CBY did not act sooner. According to al-Absi, the CBY gave Watani its lowest ranking for the past three years, and allowed them to submit a qualified statement allowing for a deficit of USD 2.7 million. (NOTE: In a qualified statement, the bank is allowed to make adjustments to its balance sheets pending future transactions, and is generally prohibited by central banks. END NOTE.) This should have set off alarm bells, said Mullinax, and prompted immediate action such as the replacement of the board of directors. Olafi attempted to take action earlier, said al-Absi, but was prevented from doing so because of Hamdani's connections to the President and other high officials.

18. (C) In general, the CBY followed standard procedure in closing Watani, said Mullinax, but details are cause for concern. Military police were left alone with the bank's cash for an extended period of time, and no CBY officials were present at the closure. According to bank managers, the CBY warned government-owned companies and state employees months ahead of time that Watani was in danger of collapse. Yemenia and the Yemen Tobacco Company both ceased depositing funds in their accounts at Watani one month before the closure. Watani managers accused CBY officials in the clearing room of warning borrowers that the bank faced collapse, and urging them to withhold payment. CBY officials themselves held over USD 100,000 in loans from Watani, said the accounts manager, which they ceased payments on two years ago.

OITC: Mystery Company Interested in Watani Shares?

19. (C) Hamdani believes he was the target of political vendettas, accusing the MOF of withholding payment to harm his business and to prevent him from selling shares to an international company. According to Hamdani, the Office of International Treasury Control (OITC), a New York-based company currently involved in a buyout of Land Rover in the United Kingdom, expressed interest in purchasing 53 percent of Watani's shares. According to Yemeni law, foreign interests may not own more than 49 percent of a local company. In this case, however, the Central Bank expressed genuine concern over the legitimacy of OITC. The company has provided no contact information or business address. OITC does not have a web site and, according to some investment experts, may be a hoax. Olafi was perplexed as to why any reputable international company would buy a small, insolvent Yemeni bank. If OITC is still interested in purchasing the bank, said Olafi, they are still welcome to submit a bid.

Growing Concern for Yemen's Financial Health

110. (C) There is deep concern within the Yemeni financial sector about the repercussions of liquidating Watani. A number of other private commercial banks, including Yemen Gulf, Yemen Islamic Bank, and Yemen Commercial Bank, face similar difficulties and could face closure within the next

year. The bulk of Yemen Gulf Bank's loans, said al-Absi, are to only five or six people, and insider loans are common practice in most Yemeni banks. Even banks that face no liquidity problems could be adversely affected by Watani's troubles. The public's confidence is already low, said Mullinax, with just over two percent holding accounts. Yemen has no deposit insurance, and additional bank failures will frighten away any potential depositors. Yemen's credit rating could also be harmed with international banks, which provide essential guarantees for letters of credit to Yemeni traders. According to the CBY, however, 80 percent of Watani's loans are non-performing. If this is only partially accurate, said Mullinax, then liquidation is the only realistic option without a huge influx of capital from the ROYG.

Comment: ROYG Looks to Avert Financial Train Wreck

11. (C) Yemen's financial system is in serious trouble. With a large number of family-owned banks and little enforcement from the CBY, poor management practices abound, including insider loans, fraudulent accounting, and speculative investing. There is little question that Hamdani and other Watani managers engaged in all of these practices. The CBY's lack of independence exacerbates the problem, by preventing CBY officials from taking action against well-connected banking families. In the case of Watani Bank, Dr. Hamdani's connections managed to keep him afloat for several years, and widened the impact of Watani's eventual collapse. The long delay allowed a series of leaks to the public, worsening Watani's liquidity problems and perhaps contributing to a run on the bank.

12. (C) Dr. Hamdani is desperate and many of his statements appear unfounded. It is highly unlikely that OITC (if it exists), or any other international company, would be willing to bail out a failed Yemeni company. Hamdani has only himself to blame for making non-performing loans, but he is likely correct in accusing the ROYG of non-payment. The AG's decision to try Hamdani for crimes against the state appears to be a case of scapegoating, and belies a growing panic about a broader collapse of the financial sector. The ROYG is seeking to recoup whatever assets it can, whether from the bank, Hamdani, or anyone in his family, to restore confidence in the banking system. Even if Hamdani is proven guilty, he cannot be blamed for all the ailments plaguing Yemeni banks. Without swift and decisive action by the CBY to enforce banking regulations, Watani's collapse could mark the beginning of a broader crisis.

Krajeski